

Draft – For Discussion



**The Manufacturing Council**

WASHINGTON, D.C. 20230

## **Subcommittee on the U.S. Workforce**

### **Focus: Bankruptcy in Manufacturing: An Automotive Example Subcommittee Report**

Chairman:  
Fred Keller  
Chairman and Chief Operating Officer  
Cascade Engineering

James McGregor  
President  
Morgal Machine Tool

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### **Situation:**

Bankruptcies have occurred in several manufacturing sectors over the years as the industries approach maturity. The steel industry has been particularly hard hit as have other “traditional heavy” manufacturing sectors. The auto industry in North America is no different and is experiencing not only a mature industry but also the negative net pricing of globalization as well. There is a sense of real danger in the Auto industry among OEM’s and supplier executives alike. With several large bankruptcies announced, many worry whether the next one will impact them. With concern that even a major OEM could fall into this category, the possibility of widespread bankruptcies in the entire chain is feared as a possibility. Several large Tier one and two suppliers are in severe distress with very little likelihood of getting better. The latest and one of the largest Chapter 11 bankruptcies in the sector is Collins and Aikman with sales of nearly \$4 billion. This was preceded by at least 10 others for a total sales volume over \$20 billion (see chart).

Today’s Auto supply chain has evolved into a system of “co-opetition” where suppliers are often competitors and customers at the same time. When Chapter 11 bankruptcy is declared by one, there is additional stress placed on the others in the chain who are often competitors, causing them to have higher costs and to be further disadvantaged by the more poorly operated companies. One premise is that under current bankruptcy law, the better run companies are being disadvantaged by the poorer run companies who are seeking protection under Chapter 11. The result could be a “ripple” effect as good companies are forced into bankruptcy by the acts of poorly run companies.

The following circumstances have prepared the entire manufacturing sector and particularly the Auto Supply Chain for this situation:

1. Years of deflation through the effects of globalization, repeated rounds of quoting and “price checking” (the process of quoting business in the middle of a contract to others with the intent of moving it if there is someone willing to provide a lower price) have led to a consistent process of “negative net pricing” where each year prices decrease without regard to improvements in cost. At first this led to increasing innovation and increased productivity but is now regularly leading to increasingly slimmer margins in the field.
2. With so much pressure on prices even intellectual property rights are ignored by some customers, even stolen by companies in countries that do not enforce Intellectual Property Rights. This combined with the pricing concerns above has resulted often in the reduction of corporate R&D. This leads to less differentiation of products, making competition even more fierce.
3. With OEM’s feeling threatened by “lack of supply” by a few desperate suppliers and with suppliers feeling threatened by customers who may wield more power, there is significant stress in contract negotiations leading to deep misunderstandings and significant loss of trust between customer and supplier. Confrontational tactics on both sides are becoming common.
4. The Auto supply chain, as mentioned above, now has an unusual mix of competitors who are also customers, leading to potentially harmful effects to competitors during a bankruptcy.
5. Banks have become reluctant to extend new credit to the Auto Supply sector because of the stress, and several banks are withdrawing from the sector all together.
6. Commodity prices have risen dramatically.

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7. There is too much dependence on debt by suppliers in this traditionally cyclical industry. The result in a bankruptcy is that senior lenders get their money, but other suppliers in the chain are largely left without receiving payment.
8. Once entered into Chapter 11 bankruptcy, the costs for attorneys, accountants and other consultants are enormous. Several hundred million dollars have come out of the Auto Supply sector in the bankruptcies that are currently active.

Clearly there needs to be some rationalization in an industry that has too much capacity. In some respects the natural process of the weak dying and the strong surviving is being threatened by bankruptcy law that allows a poor operator to put its competitor suppliers at risk by first extending their payables and then declaring Chapter 11 bankruptcy protection. Indeed it appears that antiquated bankruptcy laws allow the weak to be the survivors in a vicious race to the bottom. It has been observed that in any given sector there is a critical mass of bankruptcies beyond which the only way for survival is to have all companies enter bankruptcy. The Airline Industry may be an example of this kind of logic.

There appears to be very little system of accountability for being a poor enterprise operator. A potential solution may be to require firms that have sought protection under Chapter 11 to pay ALL suppliers even if it takes 30 years. The ease with which poor operators are able to purge their debt while burdening their suppliers with the same debt appears to be a misuse of the original intended purpose of the Bankruptcy law.

### **Recommendation:**

Department of Commerce should evaluate the impact of bankruptcies now and potentially in the future in the Automotive Supply Chain. Questions to be asked should be as follows:

1. Could there be a role for DOC to provide education for suppliers and customers on good contract law and trade compliance. Could DOC provide standards for improving the relationships in a stressed sector like automotive
2. Should bankruptcy law be modified to allow unsecured trade creditors to be more protected in the event of Chapter 11 filings?
3. Should the Bankruptcy law be altered to require fewer costs for attorneys, consultants and accountants, leaving more for suppliers?
4. Could DOC help in identifying drivers that could mitigate the probability of bankruptcies in manufacturing?

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	Name	Location	Public/ Private	Chapter 11 filed date	TOTAL SALES (\$million) (Year 2003)	Employees (Year 2003)	OEM automotive parts Sales (\$ millions) (Year 2002)		Products
							North America only	Worldwide	
1	Federal Mogul	Southfield, MI.	Public	Oct-01	6174	44700	1440	2999	Pistons, piston rings and liners, valvetrain and transmission products, systems protection, bearings, lighting, seals.
2	Collins & Aikman Corp.	Troy, MI.	Public	May-05	3984	23900	3147	3886	Cockpit modules, instrument panels, flooring and acoustic systems, fabrics, trim, convertible top systems and accessory mats.
3	Tower Automotive Inc.	Grand Rapids, MI.	Public	Feb-05	2816	12000	2066	2754	Structural components, assemblies and suspension modules
4	Hayes Lemmerz International Inc.	Northville, MI.	Public	Chapter 11 filed in Dec-2001. Emerged from bankruptcy in 2003.	2245	11000			Maker of aluminum wheels and braking components. The components segment makes automotive parts such as suspension, brake, and structural components. Other products include wheels, rims, and brakes for commercial vehicles.
5	Venture Industries	Fraser, MI	Private	Mar-03	1676	10700	570	1676	Interior/exterior components, systems and modules.
6	Meridian Automotive Systems	Dearborn, MI.	Private	Apr-05	1000	5600	974	986	Bumper systems, composites, exterior lighting, console modules and trim.
7	Oxford Automotive Inc.	Troy, MI.	Private	Chapter 11 filed Dec- 2004. But emerged from Bankruptcy March 2005.	1000	6600	454	841	Structural components, suspensions, chassis, assemblies and modules.
8	Intremet Corp.	Troy, MI.	Public	Sep-04	731	5652	725		Chassis, drivetrain, and structural cast metal components.
9	Citation Corp.	Birmingham, AL.	Private	Sep-04	650	5000	470	480	Aluminum, iron castings, steel forgings, machined components.
10	Andover Industries / Buffalo Molded Plastics Inc.	Troy, MI.	Private	Oct-04	120	500			Door panels, knee bolsters, claddings, and seat backs. in-mold lamination. Tier 1 supplier to DCX, Ford, GM. Also operates under the name Buffalo Molded Plastics Inc.,
11	Universal Automotive Industries	Alsip, IL.	Public	May-05	59.3	234			specializes in the distribution and manufacture of brake rotors and other brake parts

<b>Total</b>	<b>20,455</b>	<b>125,886</b>
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